HISTORY OF BANK INDONESIA : MONETARY
Period from 1959-1966

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1. Highlights

From 1960-1965, as the Government's policies were more focused on political interests, the Indonesian economy faced a serious problem. The guided economic doctrine had virtually drained up the country's economic potentials as they were used to finance the government's political projects. It was not that surprising that this period experienced extremely low GDP growth, exceptionally high inflation rate that reached 635% in 1966 and flagging investment. In implementing monetary policies, Bank Indonesia was burdened with Multiple Objectives, namely maintaining the rupiah stability and playing the role of the circulation bank which disbursed loan advance to the Government, extended liquidity loans and direct loans to state institutions and the businessmen.

Initially in 1959, the government adopted the tight money policy in a bid to cope with the inflationary pressure. This policy was implemented by, among others, issuing the credit ceiling for all banks on individual case on April 8, 1959. In addition, the government announced the monetary sanitation move on 25 August 1959 by lowering the value of fractions of Rp500 and Rp1,000 to respectively Rp50 and Rp100, and froze current account deposits and time deposit as much as 90% for the value exceeding Rp25,000 and turned into long-term saving. The efforts to curb inflation went on until early 1960s by way of restricting the bank loans both quantitatively and qualitatively.

On 25 August 1959, the Government devaluated the rupiah exchange rate as much as 74.7% from Rp 11.40 against USD to Rp 45 against US. However, such rupiah devaluation was not applicable to calculation of taxable earnings and revenues and nor taxes. Subsequently, the Government determined the export-import duties linked with the rupiah value. Such provision obligated the exporters to pass on the export levies amounting to 20% from the sales price, while the importers were obligated to pay import levies to the Government in the amount of 0-200% depending on the types of imported goods.

During the first half of 1960s, the Government's expenditures were soaring, particularly to finance the government's projects which raised the inflationary impact towards the state coffer. To respond to this, on 13 December 1965, the government emitted new rupiah banknotes of which their value was compressed. The denomination of Rp 1,000 was squeezed to Rp1 of the new banknote. Furthermore, to defend the foreign exchange reserve which continued to slide throughout this period, the government controlled the foreign exchange sources, namely the traffic of the trading, earning and spending of foreign exchange in the sector of services and capital supervision to prevent capital flight.

During the period of the Guided Democracy, the Indonesian foreign policies were in favor of the East Block. Indonesia's closeness to China and Russia strained Indonesia's relationship with the West. Worse, under the pretext of the revolutionary and self-reliance spirit, on 17 August 1965, the government decided to withdraw from IMF, the World Bank and the United Nations. Upon such withdrawal, the plans to repay the debts over the Outstanding Drawing according to the agreed schedule were replaced with the Settlement of Account agreement. Indonesia's outstanding to IMF amounting to USD 61.9 million surged to USD 63.5 million including interest would be repaid through 10 installments of every 6 months as from 17 February 1966. The economic condition that became uncontrollable under the Guided Economy made the government prohibit BI from issuing its Annual Report and Monetary Statistics. The ban was aimed at maintaining the country's economic stability.

2. Monetary Tightening Policies of 1959

The economic condition of 1959 was characterized with high inflation rate. To cope with this, the government issued the monetary tightening policies through credit supervision, rupiah devaluation, monetary sanitation, and foreign exchange policies. In this period, the government launched a series of measures in finance (sanitation) which made the banks face liquidity problems. To address the problem, Bank Indonesia extended liquidity loans to banks and postponed the application of credit ceiling provisions for banks. The policy to restrict credit disbursements was considered hindering the banks from growing. Afterwards, the government changed its monetary policy strategy by raising its cash ratio. As a result, the credit extension rose. In addition, the government supervised the credit extension qualitatively to the productive sectors with export oriented. The rupiah devaluation policy affected the export value. The last policies introduced during this period were PUEKS and PUM.

High inflation rate disadvantaged the economic condition of a country. Such occurred in the Republic of Indonesia in 1959. This prompted the government to issue the tight money policy, namely the policy to supervise loans quantitatively and qualitatively, rupiah devaluation policy, monetary sanitation policy and foreign exchange policy for foreign payment traffic aimed to check the inflation. How did the policies adopted overcome the inflation? You'll find out whether the policies were successfully implemented or not in the following article.

Monetary policies were the policies carried out by the Central Bank to regulate the amount of money circulated into the economy as to cope with macroeconomic issues such as inflation, unemployment and ensure economic growth. The monetary policies were executed through supervision to make sure that the amount and structure of the money being circulated were able to help create productive and stable economic activities as well as speed up the economic growth.

Inflation refers to the situation whereby prices in general are going up. Three sectors are responsible for sparking inflation, they are: (1) export and import; (2) saving and investment; and (3) state revenue and expenditure. Inflation will not occur if these three sectors are in balance. The causes of inflation may be divided into the government sector and the private sector. Inflationary pressure will emerge from the government sector if the its expenditure is bigger than its revenue, while in the private sector, inflationary pressure will emerge if the banks disburse huge amount of loans to meet such private sector's borrowings to finance various activities for both investment or non-investment purposes.

To cope with the inflation, the central bank may issue monetary policies by restricting credit extension or reduce the money in circulation through three ways: discounting policy, open market operations, and increase cash ratio.

The discounting policy is made by raising the interest rate in such a way that discourages the creditors to disburse loans and meet the demand from the public. In this way, the loans extended by the lending institutions will be reduced which in turn ease the inflationary pressure.

Open market operations, or normally called tight money policy is implemented by selling commercial paper, such as government bonds to the public and banks. As a result, the amount of money in circulation and credit disbursement by the credit institutions (banks) will be reduced which in turn ease the inflationary pressure.

Cash ratio is the ratio between the cash in the banks & demand deposit in the central bank and demand deposit of the public in the said banks. Increasing cash ratio of the banks will be anti-inflationary measure as this move will reduce the banks' ability to extend credit to the public.

Political and Economic Conditions in 1959

Presidential Decree of 5 July 1959 brought in fundamental changes to the political and economic sectors in Indonesia, including the implementation of the duties and policies of Bank Indonesia (BI).

The Indonesian economic condition in 1959 was marked with high inflation as a result of the fast increase of the money circulated due to the expansion of the government sector. To address this problem, the government issued a series of tight money policies as follows:

1. Credit supervision policy, quantitatively and qualitatively
2. Rupiah devaluation policy
3. Monetary sanitation policy
4. Foreign exchange policy for foreign payment traffic

Monetary Policy of 1959

Quantitative Credit Restriction Policy

Quantitative credit restriction policy was carried out by limiting the amount of loans that might be disbursed by the lending institutions (banks) up to a certain amount.

In the meeting held on 8 April 1959, the Monetary Board stipulated that the banks were prohibited from extending credit exceeding the amount disbursed by the said banks at the end of August 1958. The banks were given three months from 16 April 1959 to adjust their credit disbursement. Apart from that, it was mandatory for the banks to put 75% of their excessive cash in the "Extraordinary Account" of Bank Indonesia.

On 10 May 1959, the Monetary Board issued some exceptions to the above provisions over state-owned enterprises assigned to import nine basic stuffs (textile, flour, weaving thread, cotton, cement, concrete steel and concrete rope, gunny sack, paper and tiplate). In this case, the lending institutions could disburse funds up to 50% from the export receipt price payable in respect to the purchase of such goods.

In reality, the banks found it hard to adjust the amount of the credits extended. They did so because the banks were hard to withdraw the loans already disbursed. This was evident as at the end of March 1959, the total amount of credits disbursed was recorded at Rp1.270.6 million higher than the ceiling as determined, namely Rp

5,177.8 million. To overcome this, the Monetary Board issued a new provision pertaining to the credit ceiling and cash ratio/reserve requirement.

Through the meeting held on 3 August 1959, the Monetary Board set the new credit ceiling for each individual bank as from 4 August 1959.

On 25 August 1959, the government launched a monetary sanitation policy by enacting Government Regulation in lieu of Act No. 2 and No. 3 of 1959. The execution of this policy made the banks experience liquidity problem and this prompted BI to immediately issue the policy to disburse (emergency) liquidity loans to the banks and delayed the application of the credit ceiling policy for the banks (pursuant to the Meeting of the Monetary Board on 3 August 1959). Besides that, the provision on cash ratio/reserves stipulated by the Monetary Board issued through Decree No. 28 and No. 33 of 1957 was postponed with some exception to the provision on State Treasury Paper (KPN) and surplus cash paid to the Extraordinary Account of Bank Indonesia.

Prior to the government's operation in the monetary sector, the total investment in State Treasury Paper (KPN) reached Rp716.6 million exceeding the target of Rp566.9 million. However, this target went down in August 1959 to Rp 517.3 million as a result of the lifting of the mandatory State Treasury Paper investment for Nationale Handelsbank NV (due the nationalization on 19 August 1959) and Bank Timur NV. Following the government's operation in the monetary sector carried out since August 1959, the banks' investment in State Treasury Paper was shrinking from Rp714.6 million in August and Rp584.50 million in September. Even in December 1959, banks' investment in State Treasury Paper reached only Rp486.70 million, below the target of Rp517.30 million. The reason for this was the failure of some banks to meet their obligations due to liquidity problem.

Meanwhile, in terms of credit extension by 13 foreign exchange banks and BI based on the Annual Report of 1959-1960, it showed a rising trend. In the end of March 1960, the amount already doubled that of the end of July 1959 before the government launched a monetary operation. Within five months after the government began its monetary operation in August 1959, the total amount of credit channeled by the banks rose to Rp11,432.1 million in the end of December 1959 from Rp6,326 million in the end of July 1959. This increase was attributed to the credit growth extended to the sectors that were not subject to the credit ceiling.

Upon the monetary sanitation policy through the enactment of Government Regulation in lieu of Act No. 3 of 1959, the government obligated all lending institutions to transfer the saving balance frozen by them in response to the monetary operation measures dated 25 August 1959 to the Thesauri account of Bank Negara Indonesia. Such transfer had to be carried out in compliance to the provision contained in Regulations of the Finance Minister No. 1 dated 28 January 1960 and No.2 dated 22 February 1960. The banks had to maintain their own liquidity as to meet such obligation. To accommodate this interest, the government issued a regulation by way of Regulation of the Finance Minister No. 3 dated 12 January 1960 that as from 1 April 1960, all private banks and state banks had to restrict their loan disbursement that reached its balance position as per the end of February 1960. If the credit balance position exceeded the ceiling as determined in such provision, the said banks not later than three months as from the issuance date of the provision would have to adjust their disbursed credit to the credit ceiling as determined.

As regards the new credit ceiling, the Monetary Board's restriction did not apply for the loans extended by Credit Guaranteed Institution Foundation (LDK) channeled via the banks. The extension of import credit to 8 (eight) State-Owned Enterprises over 9 (nine) basic stuffs and credit purchase for the Rice Purchasing Board which had been sparred from the credit ceiling, as from the end of February 1960, such credit was also subject to the credit ceiling as determined.

In view of the one-year experience upon the introduction of the monetary sanitation policy, the government became aware that any quantitative credit restriction through credit ceiling for each individual bank, in its practice had to be reviewed to conform to the latest prevailing condition. In addition, such quantitative restriction apparently hampered the banks' progress.

Based on the above, on 15 October 1960, the government issued Government Regulation No. 5 of 1960 regarding the "the determination of basic and minimum ratio between the amount of liquid instrument owned (such as the cash owned by the banks) and the amount of obligations (such as payable bank drafts) which could be immediately collected from all banks with minimum part from the liquid instruments owned by the banks as the current account in Bank Indonesia (regulation on cash ratio)". The amount of ration based on this provision was as follows:

1. The provision on the credit ceiling by the banks up to the amount already disbursed at the end of February 1960 as stipulated in Regulation of the Finance Minister No. 3 dated 12 April 1960 was declared null and void.
2. The government determined the regulation cash ratio of 30% .
3. All banks had to keep at least 10% of their liquidity instruments calculated in the cash ratio in Bank Indonesia.
4. Within 3 months from the enactment of Regulation of the Finance Minister No. 5 of 1960, the banks had to own cash ratio of 30%.
5. Any violation to such mandatory regulation would be subject to interest penalty within three months after the enactment of Regulation of the Finance Minister No. 5 of 1960. The provision on the penalty was as follows:

    - 1% interest (one percent) per annum was imposed over any violation that lasted for not more than 3 fiscal months in a row. Such interest rate was later enlarged to 4% per annum in accordance with Decree of the Minister for the Central Bank Affairs No. 4 of 1965.
    - 9% interest (nine percent) per annum was imposed over any violation that lasted for more than 3 fiscal months in a row. Such interest rate was later enlarged to 12% per annum in accordance with Decree of the Minister for the Central Bank Affairs.

Upon the issuance of Decree of the Minister for the Central Bank Affairs No. 5 of 1960, the Regulation the Finance Minister No. 3 of 1960 was revoked and declared null and void as from 15 October 1960.

Qualitative Restriction of Loan Disbursement Policy

Apart from quantitative restriction of credit extension, the government also issued the provision on qualitative restriction on credit extension. Loan disbursement to certain sectors was restricted as credit was only extended to productive businesses

and export. As from September 1959, banks were prohibited from extending credit for any import transaction, with the exception of the goods imported by and through State Trading Companies (PDN), rice by the Logistic Agency and cambric by the Association of Indonesian Batik Cooperatives (GKBI). As a result, the importers had to submit special guarantee to their banks amounting to 100% of its counter value (in rupiah) for each import transaction. Such value included the price components, SIVA retribution, donations for the National Monument, LAAPLN retribution and bank charges which had to be fully paid during the closing of Foreign Exchange contract (KV) or L/C opening by relying on the importers' own financial sources. This provision was not applicable to State-Owned Enterprises (PN).

However, the banks were still able to disburse loans to importers wishing to import raw or support materials for own use and non-importers who were entitled to some allocation of raw or support materials for use in own companies.

Currency Devaluation Policy

Pursuant to Government Regulation (PP) No. 43 of 1959, the government devaluated rupiah from Rp 11.40 to Rp 45 against USD (basic rate). In addition, the multiple exchange rate system which had been effective from 12 March 1950 was changed to the fixed rate system. Government Regulation in lieu of Act No. 4 of 1959 dated 24 August 1959 that took into force from the following day eliminated the Export Bonus system (BE) introduced on 25 January 1957.

This policy affected the foreign payment traffic. The average export earnings of 1959 were much better compared to those of the previous years, although they were below the average figures of 1954-1956. In addition, this action sparked revaluation of the gold and foreign exchange posts at the Foreign Exchange Fund of Bank Indonesia as well as other foreign exchange banks. From the total additional money amounting to Rp 13,988 million generated from the foreign sector, most of it was earned from the gold and foreign exchange posts which had underwent extra mutation worth Rp 12,350 million.

Monetary Sanitation Policy

Sanitation means cleaning and reorganization. The monetary sanitation that was introduced on 25 August 1959 was as follows:

1. The value of the banknotes of Rp 500 and Rp 1,000 was cut to Rp 50 and Rp100 (pursuant to Government Regulation in lieu of Act No. 2 of 1959 dated 24 August 1959). The old banknotes had to be exchanged with the new ones not later than 1 January 1960 (pursuant to Government Regulation in lieu of Act No. 6 of 1959 dated 25 August 1959). Meanwhile, for the value that had been gone as a consequent of the enactment of Government Regulation in lieu of Act No.2 would be overlooked in the profit/loss or tax calculation (pursuant to Government Regulation No. 5 of 1959 dated 25 August 1959).
2. 90% of the current account and time deposit worth more than Rp25,000 were frozen and was replaced with long-term saving by the government, pursuant to Government Regulation in lieu of Act No. 3 of 1959 dated 24 August 1959.

The above monetary sanitation measures definitely sparked several impacts to the monetary sector. From the decrease of the money in circulation, rising government's

earnings to Rp 8,521 million (resulted from the decrease of banknotes value of Rp 1,000 and Rp 500 following the monetary measure on 25 August 1959 (pursuant to Government Regulation in lieu of Act No. 2 of 1959) used to reduce the government's cash shortage, to the reduction of banks' liquidity. Consequently, the banks were unable to extend loans to the companies to fund their export, import, production and distribution activities. This in turn sparked price hike of goods and cost of living in 1959. This measure which was considered a failure had been initiated by the government without coordinating with BI. As a result, the Governor of BI then, Loekman Hakim, submitted a letter of resignation to the president.

Foreign Exchange Policy

Pursuant to Government Regulation No. 42 of 1959 on Export Levies (PUEKS) and Import Levies (PULM), for any export based on the Foreign Exchange Contract closed on or after 25 August 1959 was subject to 20% Export Levies from the sales price according to the new conversion rate (USD 1 = Rp45). The export Levies were payable upon handing over the said foreign currencies. If the export was carried out through consignment, these export levies were payable when the consignment had been transferred to Indonesia or upon the submission of the forms already signed by the customs. Apart from this, the consignors had to first withdraw the bank drafts, and the banks had received the shipping documents.

Export Levies were also imposed to any conversion of foreign currencies to rupiah for invisible transactions, such as foreign currency transfer and handover of gold to the foreign exchange funds based on Rp49,203.95 for each kilogram of pure gold.

Import Levies basically were equal to Extra Import Levies (TPI). The collection of import levies was determined on the basis of C&F (in rupiah) from imported goods. The amount of import levies were set at 0% for the goods under category I, 25% for category II, 50% for category III, 100% for category IV, 150% for category V, and 200% for category VI. This classification was determined by the government. Upon the enactment of this regulation, the government eliminated the importers' obligation for prepayment when applying for the import licenses to the banks.

The provision on both export levies and import levies was revoked through Government regulations in lieu of Act No. 32, No. 33 and No. 34 of 1960 on the use of rupiah currency in foreign payment traffic. These regulations also determined that export of food crops to outside the Indonesian Custom Zone would be subject to 10% export duty from F.O.B price based on USD 1 = Rp 45.

Imported goods were divided into two categories, namely category I for essential goods for the economy and category II for other goods that were still needed. Import was subject to extra import levies based on USD 1 = Rp 200. The sales of foreign exchange by the banks for certain services was determined by the Minister of Finance and was subject to 100% transfer tax from its counter value (in rupiah) against the said foreign currencies according to the basic rupiah conversion rate.

The Development of Money in Circulation of 1959-1960

The money in circulation in 1959 and 1960 went up, namely Rp5,518 million and Rp 12,953 million compared to Rp10,453 in 1958. This addition occurred in four sectors as follows (Table 1):

Table 1
The Sectors that Affected the Money in Circulation from 1958-1960
(in million rupiah)

Sector	1958	1959	1960
Official sector	+10,858	+8,614	+2,519
Private sector	-850	+1,075	-1,224
Foreign sector	+580	+13,988	-4,472
Other sectors	-135	-18,159	+7,186
Addition of Money in Circulation	+10,453	+5,558	+12,953

In 1959, "the foreign sector" contributed most significantly to the money in circulation. This posed the impact of the gold and foreign exchange revaluation in the Foreign Exchange Funds in Bank Indonesia and other foreign exchange banks as a result of the devaluation announced on 25 August 1959 (USD 1 = Rp45, and 1 kg of pure gold = Rp 50,510.80). If the mutation of additional money in circulation resulted from gold and foreign exchange revaluation were not counted, the largest source in 1959 came from the official sector (Rp 8,614 million). The additional money in circulation was a result of credit extension to companies and government's foundations in the amount of Rp 5,257 million, including extra loans to the foreign companies that had been nationalized.

Throughout 1959, the amount of cash rose (Rp 6,511 million) while the demand deposit dropped (Rp 993 million), and the total money in circulation soared (Rp 5,518 million). On one hand, such growth increased the effective demand for credit, but on the other hand, the supplies of goods, either domestic production or import, did not add proportionately. As a result, this sparked price hike of goods and cost of living.

In 1960, the amount of demand deposit went up to 29% from the total of money in circulation. The amount of loans extended to the state companies and foundations grew to Rp 3,327 million as a result of government policy to overcome the company liquidity problems.

The tight monetary policy of 1959 launched by the government failed to ease inflation but it aggravated it. This was evident from the increase of the money circulated in 1959 and 1960, namely Rp5,518 million and Rp12,953 million compared to Rp 10,453 in 1958. The bottom line was this policy was ineffective

3. Tight Money Policy on 13 December 1965

For the very first time in the monetary history, Indonesia depleted its gold reserve and foreign exchange following the ongoing confrontation moves against Malaysia and the huge government's spending on prestigious projects such as the Games of the New Emerging Forces (Ganefo), and Conference of the Emerging Forces (Conefo). Besides, the government policies to the "raise the revolutionary funds", the monetary sanitation policies proved to add to the economic mayhem and spurred inflation. In order to prepare for the monetary uniformity all over Indonesia, on 13 December 1965, the government emitted a new payment instrument system which was valid throughout the country. Such provision included the comparison value of new rupiah against the old one, namely IB Rp 1 = Rp 1 (new) and Rp 1,000 (old) = Rp 1 (new) and the annulment of Bank Negara Indonesia's banknotes, the government's banknotes and coins which had been circulation prior to the enactment of Government Regulation No. 27 of 1965. From this day until August 1966, the new rupiah and old rupiah were circulation in tandem. And to address this duality, all private institutions were obliged to only apply the new rupiah value for transactions of goods and services as well for financial administration purposes. While the value of new rupiah is 1,000 times that of the old one, it did not mean that the prices became one thousandth of the previous ones. Nonetheless, this policy even posed more burdens to the government and added the quantity of money in circulation. Besides, inflation also went up. Thus, the monetary tightening measure taken in 1965 was considered not meeting the target.

Imagine if a country has several currency units with different values. This will definitely spark the country's chaotic monetary situation in the country. Indonesia did experience this in the 1960s. In order to create monetary unit, the government through Presidential Decree No. 27 of 1965, issued new rupiah currency to replace the old rupiah, and the one for Special Territory of West Irian Province (IB Rp). What implications did the Decree enactment have on the Indonesian monetary situation?

The following article retraces the impacts of the Presidential Decree No. 27 of 1965 amidst the government financial turmoil due to the financing of confrontational politics and ambition-driven projects.

Money came into use when economic condition became so developed that barter economy (the economy requiring double coincidence of want) implied so. Money plays a vital role in the economy. This is seen from its function as an exchange instrument, measurement tool for unit count as well as future payment standard measurements as well as purchasing power containment.

Money is one object among a number of such in an economic notion. Money carries value for which people place

demands. Changes of money value are closely related to changes of the people's demands for money. In other words, its fluctuation is inseparable from the law of supply and demand. In short, money is the quantity of goods and services given in return for the money paid.

Monetary value fluctuations depend on the increase or decrease in purchasing power. An increase in demand for money results in people's desire to keep their cash. This tends to increase money value and decrease prices of goods. On the contrary, a decrease in demand for money, as seen when people continually spend their money, will decrease the money value and increase prices. On one hand, increases in money value will lessen economic activities. On the other hand, decreases in money value will gradually trigger economic activities. The ever-decreasing money value will spark inflation. Monetary policies are one of the policies implemented to stem economic inflation in a country.

In 1965, one the monetary policies implemented to slow down the inflation rate then was through the enactment of the Presidential Decree No. 27 of 1963 dated 13 December 1965. One of the objectives of the Decree was to make way for monetary unity for all territories of the Republic of Indonesia. It was imperative that regulations for valid paying instrument acceptable in the territories of the Republic of Indonesia, including the West Irian Province, be issued.

Economic Conditions

From 1961 the government of the Republic of Indonesia financed its balance deficit by using its foreign exchange and gold deposits. In late 1965, in the country's first monetary history, Indonesia used up all its foreign exchange reserve and gold deposits, resulting in negative balance of US$ 3 million due to its continued confrontational politics.

In executing the guided economy, it was impossible that state banks were under sole coordination of one single institution. Indonesian President then (Ir. Soekarno) saw that it was also necessary to integrate all state banks into one organization of the Central Bank. For that reason, the Presidential Degree No. 27 of 1965 was then issued. The consideration behind the establishing of the State-Owned Sole Bank to function as the only State-Owned Bank in carrying out its activities as the issuance bank, the Central Bank, and foreign exchange bank was based on the Indonesia's Constitution and revolutionary doctrines.

The government's budget deficit from 1961 to 1965 was widening as follows: 29.7% (1961), 38.7% (1962), 50.8% (1963), 58.4% (1964), and 63.4% (1965) of the total expenditure realization of the running year. The deficit resulted from imbalances between the total expenses and revenues of the year due to the government's insistence on materializing both its political and economic projects from 1961 to 1965; namely the expenses to retain West Irian territory and Trikora, the confrontation against Malaysia, and ambition-driven projects, such as *Games of the New Emerging Forces (Ganefo)*, and *Conference of the Emerging Forces (Conefo).*

To finance the projects, President Soekarno as mandated by the MPRS (Provisional People's Sovereignty Assembly) issued Presidential Instruction No. 018 of 1964 and Presidential Decision No. 360 of 1964 containing regulations to amass and spend the "revolutionary funds". The government of the Republic of Indonesia fully authorized

the Central Bank Minister to manage these "revolutionary funds". One of ways to do so was by extending credits and funds to other individuals or companies at a determined rate in order that the funds grew bigger. With biased requirements credits were also extended to non-production sector companies (reaching Rp 338 billion of the old money). The management of the funds in fact disrupted the economy and money circulation that it was not at all surprising the inflation rate was so high. The increase in inflation rate peaked after the issuance of the Decree of the Minister of Finance of the Republic of Indonesia No. 1/M of 1961 dated 6 January 1961 stating that Bank Indonesia balance was not to be publicly announced. Meanwhile through the Prime Minister Decree No. 85/PM/1964 dated 4 May 1964, Bank Indonesia was authorized to carry out undertaking in companies. The issuance of the Decree created undesirable impacts on the people since Bank Indonesia could no longer function as the issuance bank. The secretive balance of Bank Indonesia encouraged speculative businesses.

Presidential Decree No. 27 of 1965

Presidential Decree No. 27 of 1965 regulated that:

1. From 13 December 1965, the valid paying instrument all over the territories of the Republic of Indonesia including West Irian Province was the money issued by Bank Negara Indonesia.
2. The comparative value between the old rupiah and the new rupiah as the valid paying instrument in West Irian Province and outside West Irian Province was as follows:

   IB Rp 1 was equivalent to Rp 1 (new)
   Rp 1,000 was equivalent to Rp 1 (new)

3. The withdrawal of Bank Negara Indonesia circulating banknotes prior to the enactment of the Presidential Decree No. 27 of 1965 is done in stages, namely:

   - All Bank Negara Indonesia banknotes of Rp 10,000 and Rp. 5,000 changes were invalidated from one month after 13 December 1965. The right to the replacement of the banknotes ceased on 25 February 1966 (Presidential Decree No. 1 of 1966 – State Gazette No 4 of 1966).
   - All Bank Negara Indonesia banknotes of Rp 2,500 and Rp 500 changes were invalidated from three months after 13 December 1965. Effective on 31 December 1966, banknotes, Government banknotes and coins of Rp 2,500 (two thousand and five hundred rupiah) and lower were invalidated as the valid paying instrument (Decree of Presidium Cabinet No. 56/EK/KEP/10/1966 effective on 7 October 1966).
   - All Bank Negara Indonesia banknotes of Rp 100 and lower were invalidated from six months after 13 December 1965.

Decree of Ampera Presidium Cabinet No. 31/EK/KEP/9/1966 effective since 15 September 1966 stated that the new rupiah as the valid paying instrument in West Irian Province in line with Presidential Decree No. 27 of 1965 was withdrawn from circulation. The West Irian Rupiah that was legitimately circulating as the acceptable

paying instrument based on Presidential Decree No. 2 of 1963 remained acceptable in West Irian Province.

The First Minister for the Economy and Finance issued Circular No. EK/1964/23/66 on 20 August of 1966 as the continuation of Presidential Decree No. 27 of 1965 to state that to terminate the dualism, all private institutions were instructed to adopt the new rupiah value to determine calculation of prices of goods and services and financial administrative needs starting from 1 October 1966. The regulation was issued because since the circulation of the new rupiah in December 1965 up to the issuance of the Circular, the old and new rupiah were concurrently circulating. The circulating old rupiah had considerably lessened while the new rupiah had been circulating all over Indonesia.

The issuance of the new rupiah of which the value was 1,000-fold of the old rupiah did not necessarily mean that prices of goods in the new rupiah would become one-thousandth of the old rupiah prices. Instead:

1. Government's Expenditure from Rp (new) 2,526 million in 1965 increased to Rp (new) 29.867 million, or more or less 12-fold.
2. Circulation of the RP (new) 25.72 billion in 1965 increased to 22.208 billion in 1966, or 9-fold.

This showed that the exchange value between the old rupiah and the new rupiah ranged between 1 and 10. The public viewed it as 10-fold higher than the old rupiah.

Implications of the Policy on Money in Circulation Development

The money circulating in the end of July 1959 amounted to Rp 33,987 million, while in the end of August 1959, it was recorded to decrease to Rp 12,988 million from Rp 20,999 million, or a drop of 38.2% within a month. In the end of December 1959, however, practically just 4 months afterwards, the money in circulation reached 34,883 million. A year later, in the end of 1960 the volume of the money in circulation grew to 47,847 million, or an increase of 37% from the end of the previous year. In the annual report of 1960-1965, the volume of the money in circulation significantly went upward annually to reach its peak in the end of 1966 at Rp 5,164,552 million.

In Bank Negara Indonesia Unit I book report of 1960-1965, the inflation rate in 1959 was recorded at around 22%, having increased steadily from year to year to reach its climax in 1966 at around 653.3%. The following is the growth of the money in circulation and inflation rates from 1958 to 1966 (first quarter):

Table 1
Volume Growth of Money in circulation and Inflation Rate of 1959 – 1966
(in Rp million)

Year	M1 *)	Growth M1	Growth M1 (%)	Inflation (%)
1958	29,372	-	-	46
1959	34,889	5,517	19	22
1960	47,842	12,953	37	38
1961	67,648	19,806	41	27
1962	135,898	68,250	101	174
1963	263,361	127,463	94	119
1964	675,105	411,744	156	135
1965	2,713,688	2,038,582,	302	594
1966	5,164,552	2,450,864	90	635.5
*) M1 = Amount of money in circulation				

The volume growth of money in circulation followed by rising prices of goods both in rural areas and in major cities was resulted from the government financial policies in August 1959. In the period from 1960 – 1966 food price index increased; both of the 12 basic commodities in the rural areas of Java and the 19 basic commodities in some major cities. Drastic increases took place in 1961 and the following years.

Apart from the monetary measures of August 1959, the incredible rise of inflation rate was also caused by the second monetary policy, namely the issuance of the new rupiah on 13 December 1965 through Presidential Decree No. 27 of 1965. That these monetary steps were off target was due to the government's lack of determination to refrain from spending large amounts of funds. To carry out projects of ambitions such as Ganefo and Conefo the government expenditures went up by the year that inflation rates followed suit', causing prices to soar.

The highest inflation rate was recorded in 1965 along with the highest amount of money in circulation in 1965. Since export revenues were unbearably poor, importation of goods and services had to be limited due to the weakening foreign exchange reserves.

4. Focus Of Policies 1959-1966

The beginning of this period witnessed a monetary sanitation move by the Government by cutting the money value by 90% from its nominal value and freezing the public saving and turning it into a long-term saving.

The beginning of this period witnessed a monetary sanitation move by the Government by cutting the money value by 90% from its nominal value and freezing the public saving and turning it into a long-term saving. Such frozen public saving in the banks had to be handed over to the Government. As a result, the banks were facing a liquidity problem.

In the political field, the Government introduced a new State Major Guidelines which were a political manifestation called Manipol USDEK which stands for the 1945 Constitution, Socialism àla Indonesia, Guided Democracy, Guided Economy and Indonesian Identity. Under this Manipol USDEK, all the resources were mobilized to support the revolutionary struggles aimed at making Indonesia a sovereign country, free from colonization and united & integrated to build up its national identity and character. During this political development, the government also developed many unproductive economic infrastructures, or more popularly known as 'the white elephant' project development.

In addition, the State Budget was burdened with numerous and new expenditures as Indonesia was in confrontation with Malaysia, liberating West Irian from the Dutch control and salary rise for the civil servants.

In the economic field, the real sector development did not show any progress. As a result, the supply of goods, particularly foodstuff remained in shortage.

Inevitably, the above conditions deteriorated the State Budget deficit which in turn led to the deficit of the foreign exchange reserves.

Like what had occurred in the previous period, such State Budget deficit was recovered with the Loans from Bank Indonesia by printing more banknotes. As a result, there was more money in circulation which inevitably triggered hyperinflation. In 1995/1965, the inflation reached a record high of 635.5%. This was the worst inflation ever happened in Indonesia's economic history. The monetary policies were therefore aimed at lowering the inflation.

5. Strategic Steps 1959-1966

To overcome the liquidity problem faced by the banks as a result of monetary sanitation, BI extended Liquidity Credit for those banks.

To overcome the liquidity problem faced by the banks as a result of monetary sanitation, BI extended Liquidity Credit for those banks. While to ease inflation resulting from the Government's spending and adding the money in circulation, BI adopted the policies to limit the credit ceiling and ban of credit disbursement to certain economic sectors. Again this policies proved ineffective like in the previous period; mainly because these policies failed to generate real output growth (economic growth). Apart from that, to add the foreign exchange reserves, export had to be further spurred by giving more incentives and rupiah devaluation. Meanwhile, the government restricted import by imposing higher import exchange rate than the official conversion rate.

6. Foreign Exchange Policies in Indonesia 1959-1966

During this period, the controlled foreign exchange regime remained being enforced and even more strictly. This was evident from the policy of collecting the export earnings and import ban of certain commodities.

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Due to international market volatility in the 1960s, Indonesia's foreign exchange earning from the rubber export, which was then the prime commodity, plummeted. The introduction of different types of synthetic rubber also put some pressure to the Indonesian rubber export output. Worse, the rice import increase was burdening the country's foreign exchange reserves. To cope with such pressures, the Government from 1964 tightened its foreign exchange policy for import purpose, and offered numerous incentives to jack up export drive.

At the end of 1964, the Government enacted Act No. 32 of 1964 on Foreign Exchange Traffic to supersede Deviezen Ordonnantie of 1940 and Deviezen Verordening of 1940. Upon the enactment of Act No. 32, the any foreign exchange in the hand of the public did not have to be handed over to the Foreign Exchange Fund. The foreign exchange remained being controlled but not through handing it over to the Foreign Exchange Fund, but its use had to obtain a strict permission. To prevent capital flight, the government controlled the traffic of capital.

The efforts to accumulate foreign exchange were continued, among others by offering more incentives to boost export.

7. Exchange Rate Policies in Indonesia 1959-1966

On 25 August 1959, the Government issued a series of policies aimed to ease the State Budget burden, improve the balance of payment and curb the inflation rate.

On 25 August 1959, the Government issued a series of policies aimed to ease the State Budget burden, improve the balance of payment and curb the inflation rate. The series of policies addressed the rupiah devaluation, monetary sanitation and amended the existing the foreign exchange policy and international trade regulations.

The devaluation was to change the rupiah exchange rate from Rp 11.4 to Rp 45 against US dollar.

This devaluation move, apart from jacking up export and causing a revaluation in the Gold Reserve and Foreign Exchange reserves in Bank Indonesia and other banks, triggered higher inflation.

The declining price of rubber in the international market was most devastating from Indonesia's entire export commodities coupled with the import increase of rice from 1957 and continued. These made country's foreign exchange reserves shrink fast in 1960. The Government managed to overcome the problem, among others, through offering higher exchange rate for the sales of foreign exchange earned from export. Under this scheme, exporters were entitled to a better conversion rate of their foreign exchange, namely Rp270 against US dollar multiplied by 95% from f.o.b. On the other hand, importers were entitled to higher conversion rate depending on their types of commodities, namely Rp270 for category I, Rp 540 for category II and Rp 810 for category III. This regulation was then amended for several times, finally on 11 February 1966 offering higher conversion rates for both exporters and importers. The amount was approximately 4,000% (four thousand percent) from its fixed conversion rate, Rp 45 against US dollar.

In other words, such fixed conversion rate of Rp 45 against US dollar in practice was subject to adjustments following the application of multiple rate system.

8. Foreign Debt Policies 1959-1966

In a bid to ease the state budget burden, and improve the balance of payment position, the Government among others resorted to foreign loans.

In a bid to ease the state budget burden, and improve the balance of payment position, the Government among others resorted to foreign loans. In line with the changes of Indonesia's foreign policies, most of the government's borrowings were obtained from the Eastern block countries, such as the People's Republic of China and USSR. These loans were used to finance large-scale projects and some 'white elephant projects' as well confrontation with Malaysia in 1964. The foreign loans obtained by the Government certainly aggravated its burden compared to the government's ability to settle the debts. As the state treasury and foreign exchange available earned from export were not favorable.

In 1959 alone Indonesia obtained two foreign borrowings, namely from US Exim Bank worth USD 6.9 million for the expansion of Semen Gresik Plant, and USD 5 million to purchase Lockheed Electra aircraft in early 1960, US Exim bank also pledged a loan of USD 47.5 million to help establish the urea fertilizer plant in Palembang and the construction of Steam Power Plant (PLTU) in Surabaya. The significant rise of loans took place in 1961 and 1962 following the disbursement of loans from the USSR, and 1963 the government obtained a fresh loan from the People's Republic of China.